The case went to trial on May 2, 2005.

Prior to the acquisition of the Acquired Businesses, XO purchased $92.5 million in face value of unsecured Allegiance debt securities. Consequently, XO is a claimant in Allegiance's bankruptcy. It is difficult to assess how much of the claim XO will recover, or when the recovery will be paid. This assessment could change based upon the total amount of claims the ATLT is directed to pay, the amount of administrative costs that it incurs, and the value of its assets, including 45.4 million shares of XO's common stock.

PART I. FINANCIAL INFORMATION

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-looking and Cautionary Statements

Some statements and information contained in this document are not historical facts, but are "forward-looking statements," as such term is defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements can be identified by the use of forward-looking terminology such as "believes," "expects," "plans," "may," "will," "would," "could," "should," or "anticipates" or the negative of these words or other variations of these words or other comparable words, or by discussions of strategy that involve risks and uncertainties. Such forward-looking statements include, but are not limited to, statements regarding:

- our services, including the development and deployment of data products and services based on IP, Ethernet and other technologies and strategies to expand our targeted customer base and broaden our sales channels;
- the operation of our network and back office systems, including with respect to the development of IP protocols;
- liquidity and financial resources, including anticipated capital expenditures, funding of capital expenditures and anticipated levels of indebtedness;
- trends related to and expectations regarding the results of operations in future periods, including but not limited to those statements set forth in Management's Discussion and Analysis of Financial Condition and Results of Operations below; and
- The impact of judicial decisions, legislation, and regulatory developments on our cost structure, services, and marketing initiatives.

All such forward-looking statements are qualified by the inherent risks and uncertainties surrounding expectations generally and also may materially differ from our actual experience involving any one or more of these matters and subject areas. The operation and results of our business also may be subject to the effect of other risks and uncertainties in addition to the relevant qualifying factors identified in the "Liquidity Assessment" discussions set forth below and the "Risks and Uncertainties" discussion and the "Risk Factors" section of our 2004 Annual Report, including, but not limited to:

- general economic conditions in the geographic areas that we are targeting for the sale of telecommunications services;
- the ability to achieve and maintain market penetration and average per customer revenue levels sufficient to provide financial viability to our business;
- the quality and price of similar or comparable telecommunications services offered, or to be offered, by our current or future competitors; and
- future telecommunications-related legislation or regulatory developments and the conduct of incumbent carriers in reaction to such developments.

Management Overview

We provide a comprehensive array of telecommunications services to business customers. We provide our services, including local and long distance voice, Internet access, private data networking and hosting services, through our national telecommunications network, which consists of more than 6,700 route miles of fiber optic lines connecting 953 unique Incumbent Local Exchange Carrier, or ILEC, end-office collocations in 37 U.S. cities. In addition, we own licenses to deliver telecommunications services via local multipoint distribution service, or LMDS, wireless spectrum in all of the largest U.S. cities. We market our services primarily to business customers, ranging from small and medium businesses to Fortune 500 companies to carrier and wholesale customers. Our services offer an effective telecommunications solution for nearly any business, and our national telecommunications network is particularly advantageous to multi-location businesses that desire to improve telecommunications among their locations, whether within a single metropolitan area or across the country.

To serve our customers' broad telecommunications needs, we operate a network comprised of a series of rings of fiber optic cables located in the central business districts of numerous metropolitan areas, which we refer to as metro fiber networks, that are connected primarily by a network of numerous dedicated wavelengths of transmission capacity on fiber optic cables, which we refer to as an intercity network. By integrating these networks with advanced telecommunications technologies, we are able to provide a comprehensive array of telecommunications services primarily or entirely over a network that we own or control, from the initiation of the voice or data transmission to the point of termination, which we refer to as end-to-end service. This capability enables us to provide telecommunications services between customers connected to our network and among customers with multiple locations primarily or entirely over our network.

With the acquisition of Allegiance Telecom, Inc.'s, or Allegiance's, network assets and customer base, which we refer to as the Acquired Businesses, in June 2004, we became one of the nation's largest competitive providers of national local telecommunications and broadband services. We own one of the largest networks of nationwide connections to the Regional Bell Operating Companies', or RBOCs', networks, and doubled our Points of Presence (PoPs) within the 36 metropolitan areas where both XO and Allegiance operated. We believe that this extensive network will allow the combined company to (i) improve delivery of service to customers, (ii) improve operating results, and (iii) improve our ability to compete with other companies in the nationwide local telecommunications services market.

Management uses certain key performance indicators, or KPIs, to assess operational effectiveness of the business, including:

- Gross Margin
- EBITDA
- Sales, Operating and General Expenses as a Percentage of Revenue

The following table outlines the measurements of these KPIs as a percentage of revenue for the first quarter of 2005 and 2004:

	Three Months Ended March 31, 2005	2004
Gross margin	59.1%	57.9%
EBITDA	6.0%	(6.9%)
Sales, operating & general expenses	53.0%	64.6%

Management believes that EBITDA and gross margin are measures of operating performance and liquidity that reflect the ongoing effectiveness of management's sales, cost reduction and acquisition initiatives. Sales operating and general expense is an important measure of the efficiency with which the company sells, provisions and supports its services, and the efficiency of its back office operations. See the further discussion of EBITDA and gross margin in the Comparison of Financial Results section below.

Recent Events

In March 2005, we retained Jefferies & Company, Inc. ("Jefferies") to present strategic alternatives based on, among other things, the competitive environment of the telecommunications industry, the current regulatory environment, and the recent and pending mergers and acquisitions in our industry. We have received the Jefferies report, which addressed potential operational improvements and disposition possibilities, and are considering all of our strategic alternatives.

On April 18, 2005, we launched the Company's initial Voice over Internet Protocol, or VoIP, product, named XOptions Flex, in 45 markets. VoIP enables customers to utilize "dynamic bandwidth allocation" to maximize the utilization of their bandwidth by allocating it for data applications during periods when voice lines are idle. XOptions Flex bundles unlimited local and long distance calling, dedicated Internet access and web hosting services for a flat monthly price.

We have begun offering fixed broadband wireless backhaul services to mobile wireless telecommunications carriers. In April 2005, we reached an agreement to provide fixed broadband wireless services on a limited basis to one of the national mobile wireless carriers. The Company will continue to pursue opportunities to market and sell its fixed wireless solution to mobile wireless carriers both for primary network connectivity and redundancy.

Results of Operations

The operational results of XO for the three months ended March 31, 2005 are discussed below. As the acquisition of the Acquired Businesses closed on June 23, 2004, or the Closing Date, our consolidated results of operations include the Acquired Businesses from the Closing Date through March 31, 2005. Forward looking information with respect to consolidated XO is discussed at the end of each financial results analysis. Our actual experience may differ materially from our projections of the combined company based on many factors including, among others:

- there are inherent uncertainties in projecting future results for any business;
- we cannot predict the outcome of future judicial decisions, telecommunications related legislation or regulatory decisions, or the reaction by incumbent carriers to such developments.

Three Months Ended March 31, 2005 versus Three Months Ended March 31, 2004

The following table contains certain data from our unaudited consolidated and condensed statement of operations presented in thousands of dollars and expressed as a percentage of total revenue. The information in this table should be read in conjunction with our consolidated and condensed financial statements, including the notes thereto, appearing elsewhere in this report (amounts in thousands, except for share and per share data):

	Three Months Ended March 31, 2005		Three Months Ended March 31, 2004	
Revenue	$ 361,504	100.0%	$ 260,945	100.0%
Costs and expenses:				
Cost of service (exclusive of depreciation and amortization)	147,922	40.9%	109,961	42.1%
Selling, operating and general	191,694	53.0%	168,553	64.6%
Depreciation and amortization	58,365	16.1%	25,697	9.8%
Total costs and expenses	397,981	110.1%	304,211	116.6%
Loss from operations	(36,477)	(10.1%)	(43,266)	(16.6%)
Interest income	1,893	0.5%	1,705	0.7%
Investment loss, net	(271)	(0.1%)	(329)	(0.1%)
Interest expense, net	(8,004)	(2.2%)	(6,604)	(2.5%)
Net loss	$ (42,859)	(11.9%)	$ (48,494)	(18.6%)
Preferred stock accretion	(3,097)	(0.9%)	—	0.0%
Net loss applicable to common shares	(45,956)	(12.7%)	(48,494)	(18.6%)
Net loss per common share, basic and diluted	(0.25)		(0.37)	
Weighted average shares outstanding, basic and diluted	181,933,035		129,406,599	
Gross margin (1)	213,582	59.1%	150,984	57.9%
EBITDA (2)	21,617	6.0%	(17,898)	(6.9%)

(1) Gross margin is defined as revenue less cost of service, and excludes depreciation and amortization. Gross margin is not intended to replace operating income (loss), net income (loss), cash flow and other measures of financial performance reported in accordance with generally accepted accounting principles in the United States. Rather, gross margin is an important measure used by management to assess operating performance of the Company. Additionally, we believe that gross margin is a standard measure of operating performance that is commonly reported and widely used by analysts, investors, and other interested parties in the telecommunications industry. Gross margin as used in this document may not be comparable to similarly titled measures reported by other companies due to differences in accounting policies. A reconciliation between gross margin and net loss is as follows:

	Three Months Ended March 31, 2005	Three Months Ended March 31, 2004
Net loss	$ (42,859)	$ (48,494)
Selling, operating and general	191,694	168,553
Interest income	(1,893)	(1,705)
Investment loss, net	271	329
Interest expense, net	8,004	6,604
Depreciation and amortization	58,365	25,697
Gross margin	$ 213,582	$ 150,984

(2) EBITDA is defined as net income or loss before depreciation, amortization, interest expense, and interest income. EBITDA is not intended to replace operating income (loss), net income (loss), cash flow and other measures of financial performance reported in accordance with generally accepted accounting principles in the United States. Rather, EBITDA is an important measure used by management to assess operating performance of the company. EBITDA as used in this document may not be comparable to similarly titled measures reported by other companies due to differences in accounting policies. Additionally, EBITDA as defined here does not have the same meaning as EBITDA as defined in our secured credit facility agreement. A reconciliation between EBITDA and net loss is as follows:

	Three Months Ended March 31, 2005	2004
Net loss	$ (42,859)	$ (48,494)
Interest income	(1,893)	(1,705)
Interest expense, net	8,004	6,604
Depreciation and amortization	58,365	25,697
EBITDA	$ 21,617	$ (17,898)

Revenue. Total revenue for the three months ending March 31, 2005 increased 38.5% to $361.5 million from $260.9 million for the three months ending March 31, 2004. Substantially all of the increase is attributable to the inclusion of the Acquired Businesses in the results for the three months ending March 31, 2005.

We believe that revenue for the remainder of 2005 will increase in absolute dollars relative to the first quarter of 2005 results, attributable largely to price increases that will be implemented to offset the impacts of recently enacted FCC rules on UNE loop and transport rates discussed in the "Regulatory Overview" section below.

Revenue was earned from providing the following services (dollars in thousands):

	Three months ended March 31,				
	2005	% of Revenue	2004	% of Revenue	% Change
Voice services	$186,298	51.5%	$130,921	50.2%	42.3%
Data services	108,392	30.0%	92,949	35.6%	16.6%
Integrated voice and data services	66,814	18.5%	37,075	14.2%	80.2%
Total revenue	$361,504	100.0%	$260,945	100.0%	38.5%

Voice services revenue includes revenue from local and long distance voice services, prepaid calling card processing, interactive voice response services, stand-alone long distance services and other voice telecommunications based services. Revenue from voice services increased $55.4 million or 42.3% as compared to the same period in 2004. Substantially all of the increase is attributable to the inclusion of the Acquired Businesses in the results for the three months ending March 31, 2005.

Data services revenue includes revenue from Internet access, network access and web hosting services. Revenue from data services revenue increased $15.4 million or 16.6% as compared to the same period in 2004. Substantially all of the increase is attributable to the inclusion of the Acquired Businesses in the results for the three months ending March 31, 2005.

Integrated voice and data services revenue includes revenue from our XOptions and Total Communications service offerings, XO's flat-rate bundled packages offering a combination of voice and data services and integrated access. Revenue from integrated voice and data services increased $29.7 million or 80.2% as compared to the same period in 2004. Substantially all of the increase is attributable to the inclusion of the Acquired Businesses in the results for the three months ending March 31, 2005.

Costs and expenses. The table below provides costs and expenses by classification and as a percentage of revenue (dollars in thousands). Our consolidated costs and expenses in the first quarter of 2005 include the costs to run the Acquired Businesses.

	Three months ended March 31,		Three months ended March 31,		
	2005	% of Revenue	2004	% of Revenue	% Change
Costs and expenses:					
Cost of service (excluding depreciation and amortization)	$147,922	40.9%	$109,961	42.1%	34.5%
Selling, operating and general	191,694	53.0%	168,553	64.6%	13.7%
Depreciation and amortization	58,365	16.1%	25,697	9.8%	127.1%
Total	$397,981	110.1%	$304,211	116.6%	30.8%

Cost of service (exclusive of depreciation and amortization). Cost of service includes expenses directly associated with providing telecommunications services to our customers. Cost of service includes, among other items, the cost of connecting customers to our network via leased facilities, the costs of leasing components of our network facilities and costs paid to third party service providers for interconnect access and transport services. Cost of service as a percentage of revenue for the three months ended March 31, 2005 decreased as compared to the same period in 2004 primarily due to a $10.0 million settlement with SBC (the "SBC Settlement"). Excluding this settlement, Cost of service as a percentage of revenue increased as compared to the same period in 2004. This increase was primarily due to the impact of pricing pressures from both mandated carrier access rate reductions and general price reductions, offset by savings from synergies associated with the integration of Acquired Businesses. We originally estimated a potential benefit of approximately $60.0 million in pro forma annualized network synergies for the combined companies if our integration efforts with the Acquired Businesses were successful. We have made substantial progress integrating the two companies and are on plan to reach our synergy targets.

We believe that, excluding the SBC settlement, cost of service as a percentage of revenue for the remainder of 2005 will remain stable relative to the first quarter of 2005 results. Cost of service will be adversely impacted due to the recently enacted regulatory rules on unbundled network element, or UNE, loop and transport rates as discussed in the "Regulatory Overview" section below. The UNE and transport rate increases will be phased in during 2005, and we expect them to have a total impact of approximately $70 million in 2006. However, we believe that actions we are taking, including negotiating rate reductions, network optimization, and price increases, will offset these increases.

Selling, operating and general. Selling, operating and general expense includes expenses related to network maintenance, sales and marketing, network operations and engineering, information systems, general corporate office functions and collection risks. Selling, operating and general expense for the three months ended March 31, 2005 was $191.7 million or 53.0% of revenue versus $168.6 million or 64.6% of revenue for the three months ended March 31, 2004. The decrease in selling, operating and general expense as a percentage of revenue for the three months ended March 31, 2005 when compared to 2004 results is primarily due to the achievement of synergies related to the Acquired Businesses. We originally estimated a potential benefit of approximately $100.0 million in pro forma annualized selling, operating and general expense synergies for the combined companies if our integration efforts with the Acquired Businesses were successful. We have completely integrated the administrative functions and have exceeded the estimated annualized synergies.

We believe that selling, operating and general expense will decrease slightly as a percentage of revenue during the remainder of 2005, due to the price increases discussed above and through continued efficiencies resulting from back office infrastructure improvements.

Depreciation and amortization. Depreciation and amortization expense was $58.4 million for the three months ended March 31, 2005, and $25.7 million for the three months ended March 31, 2004. The increase is primarily due to the inclusion of property and equipment and intangibles of the Acquired Businesses.

As of March 31, 2005, we had approximately $95.5 million of fixed assets and $23.5 million of broadband wireless licenses that have not yet been placed into service and, accordingly, are not currently being depreciated or amortized. We expect depreciation and amortization expense to increase in both absolute dollars and as a percentage of revenue during 2005 as additional assets are placed into service.

Interest income. Interest income in the first quarter of 2005 increased to $1.9 million from $1.7 million in the first quarter of 2004. The increase in interest income is due to an increase in interest rates.

Investment loss, net. Investment loss, net includes any realized gains or losses from the sale of investments. Investment loss, net was $0.3 million for each of the three months ended March 31, 2005 and 2004. The first quarter of 2005 includes a $4.0 million impairment adjustment that was considered to be other than temporary, offset by realized gains on other investments of $3.7 million.

Interest expense, net. Interest expense, net includes interest expense on debt and capital leases, less any amounts capitalized. The majority of interest expense in the three months ended March 31, 2005 and 2004 is non-cash as our secured credit facility (the "Credit Facility") allows for accrued interest to be converted into principal if unpaid. Interest expense, net for the three months ended March 31, 2005 and 2004, was $8.0 million and $6.6 million, respectively.

Net Loss. Net loss decreased $5.6 million to a loss of $42.9 million for the three months ended March 31, 2005, from a net loss of $48.5 million for the comparable period in 2004. The decrease primarily resulted from the achievement of synergies resulting from the integration of the Acquired Businesses, offset by additional depreciation and amortization from the inclusion of the property and equipment and intangibles of the Acquired Businesses. Additionally, we recognized a $10.0 million reduction in cost of service expense due to the SBC Settlement referenced above.

EBITDA. EBITDA increased to $21.6 million for the three months ended March 31, 2005 from $(17.9) million for the comparable period in 2004. The increase primarily resulted from the achievement of synergies resulting from the integration of the Acquired Businesses and the $10.0 million SBC Settlement referenced above.

Critical Accounting Policies and Estimates

Our significant accounting policies are more fully described in the notes to the consolidated financial statements in our 2004 Annual Report. The preparation of the condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States requires management to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Management uses historical experience and all available information to make these judgments and estimates and actual results could differ from those estimates and assumptions that are used to prepare our financial statements at any given time. Despite these inherent limitations, management believes that Management's Discussion and Analysis and the accompanying condensed consolidated financial statements and footnotes provide a meaningful and fair perspective of our financial condition and our operating results for the current period. Management's Discussion and Analysis and Note 3 to the Consolidated Financial Statements in the XO Communications, Inc. Annual Report on Form 10-K for the year ended December 31, 2004 describe the significant estimates and accounting policies used in preparation of the Condensed Consolidated Financial Statements. There have been no significant changes in our Critical Accounting Policies or Estimates during the first quarter of 2005.

Liquidity and Capital Resources

Capital Resources and Liquidity Assessment

During the three months ended March 31, 2005, our operating activities provided net cash of $18.3 million, our investing activities provided net cash of $5.2 million, and our financing activities used net cash of $0.9 million. Our balance of cash and cash equivalents increased to $256.6 million at March 31, 2005 from $234.0 million at December 31, 2004. In the first quarter of 2005, $25.4 million previously held in escrow was released and, accordingly, reclassified into cash and cash equivalents.

We have a secured credit facility, or the Credit Facility, which matures on July 15, 2009. There are no additional borrowings available under the Credit Facility. At March 31, 2005, more than 90% of the underlying loans of the Credit Facility are held by an entity controlled by Mr. Carl C. Icahn, Chairman of the Company's Board of Directors ("Mr. Icahn"). At March 31, 2005, long-term debt consisted of $368.5 million in principal and $5.7 million of accrued interest that, if not paid, converts to principal. There are no current debt service requirements since cash interest payments as well as automatic and permanent quarterly reductions on the principal amount outstanding do not commence until 2009. However, in the event that consolidated excess cash flow (as defined in the Credit Facility) for any fiscal quarter during the term of the agreement is greater than $25.0 million, at the request of the lender, the Company will pay an amount equal to 50% of such excess cash flow greater than

$25.0 million toward the reduction of outstanding indebtedness. In addition, if the ratio of XO's consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA"), as defined in the Credit Facility, to consolidated interest expense for four consecutive quarters exceeds 4:1, XO would be required to pay cash interest, unless waived by the lenders. The Company can elect to begin paying interest in cash prior to the required date. Loans under the Credit Facility bear interest, at the Company's option, at an alternate base rate, as defined, or a Eurodollar rate plus, in each case, applicable margins. Once the Company begins to pay accrued interest in cash, the applicable margins are reduced. At March 31, 2005, the annualized weighted average interest rate applicable to outstanding borrowings under the Credit Facility was 8.7%.

The security for the Credit Facility consists of all assets of XO including the stock of its direct and indirect subsidiaries, and substantially all the assets of those subsidiaries. The Credit Facility limits additional indebtedness, liens, dividend payments and certain investments and transactions, and contains certain covenants with respect to EBITDA requirements, as the term EBITDA is defined in the Credit Facility, and maximum capital expenditures. The definition of EBITDA in the Credit Facility differs from the definition of EBITDA discussed in "Results of Operations" above. The Company was required to achieve a minimum consolidated EBITDA of not less than $97.0 million for the twelve-month period ended March 31, 2005. The Company is also required under the terms of the Credit Facility to maintain an unrestricted cash balance of $25.0 million at the end of each fiscal quarter.

In May of 2005, we obtained a waiver of compliance with the minimum consolidated EBITDA covenant contained in the Credit Facility through December 31, 2006. The waiver was obtained from the affiliate of Mr. Icahn which holds a majority of the Company's loans outstanding under that agreement. In connection with that waiver, we agreed that in the event of a sale of the Company and in the event of other significant sale or divestiture transactions, we will prepay all amounts outstanding under the Credit Facility in cash and offer to repurchase outstanding shares of our preferred stock at their liquidation value accrued through the date of redemption for cash or, in certain events, securities. The affiliate of Mr. Icahn which holds a majority of such Preferred Stock has agreed to accept that offer, to the extent it consists of cash.

We project that we will make significant progress on our operating results such that we will be cash flow positive in 2005. Our projection is based upon, among other things, our estimated increased costs of service attributable to the recent Triennial Review Remand Order, or TRRO, discussed in the "Regulatory Overview" below, and other projected operating costs that are not entirely under our control. As a result, our 2005 projections may be incorrect if our estimates of such costs and expenses are inaccurate.

Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of trade receivables. Although our trade receivables are geographically dispersed and include customers in many different industries, a portion of our revenue is generated from services provided to other telecommunications service providers. We believe that our established valuation and credit allowances are adequate as of March 31, 2005 to cover these risks.

Regulatory Overview

Overview

We are subject to regulation by federal, state and local government agencies. Historically, the Federal Communications Commission, or FCC, had jurisdiction over interstate long distance services and international services, while state regulatory commissions had jurisdiction over local and intrastate long distance services. The Telecommunications Act of 1996, or the Telecom Act, fundamentally changed the way telecommunications is regulated in this country. The FCC was given a major role in writing and enforcing the rules under which new competitors could compete in the local marketplace. Those rules, coupled with additional rules and decisions promulgated by the various state regulatory commissions, form the core of the regulatory framework under which we operate in providing our services.

With a few limited exceptions, the FCC continues to retain exclusive jurisdiction over our provision of interstate and international long distance services, and the state regulatory commissions regulate our provision of intrastate local and long distance services. Additionally, municipalities and other local government agencies may regulate limited aspects of our business, such as use of government-owned rights-of-way, and may require permits such as zoning approvals and building permits.

The Telecom Act and the related rules governing competition issued by the FCC, as well as pro-competitive policies already developed by state regulatory commissions, have enabled new entrants like us to capture a portion of the ILECs' market share of local services. However, there have been numerous attempts to limit the pro-competitive policies in the local exchange services market through a combination of proposed federal legislation, adoption of new rules by the FCC, and ILEC challenges to existing and proposed regulations. To date, the ILECs have succeeded in eliminating some of the market-opening regulations adopted by the FCC and the states through numerous court challenges. In particular, the ILECs appealed, and won partial reversals of, a series of FCC orders defining the ILEC facilities, known as UNEs, that ILECs must lease to competitors at cost-based rates. We expect the ILEC's efforts to scale back the benefits of the Telecom Act and local service competition to continue. However, while the FCC has *eliminated certain UNEs, the basic framework of local competition for facilities-based competitors such as us, has remained intact.* The successful implementation of our business plan is predicated on the assumption that the basic competitive framework and pro-competitive safeguards will remain in place.

The passage of the Telecom Act largely preceded the explosive growth of the Internet and Internet Protocol, or "IP", communications. Congress is currently considering whether to further amend the Telecom Act to, among other things, directly address IP communications. It is possible that any such amendment to the Telecom Act could eliminate or materially alter the market-opening regulatory framework of the Telecom Act in general, and the UNE regime in particular. Such a result could adversely affect XO's business. It is not possible to predict if, when, or how the Telecom Act will be amended.

Federal Regulation

The FCC exercises jurisdiction over our telecommunications facilities and services. We have authority from the FCC for the installation, acquisition and operation of our wireline network facilities to provide facilities-based domestic interstate and international services. In addition, we have obtained FCC authorizations for the operation of our LMDS and 39 GHz broadband wireless facilities. Because we are not dominant in any of our markets, unlike ILECs, we are not subject to price cap or rate of return regulation. Thus, our pricing policies for interstate and international end user services are only subject to the federal guidelines that charges for such services be just, reasonable, and non-discriminatory. The FCC allows us to file interstate tariffs for our interstate access services (rates charged by us to other carriers for access to our network). As for domestic interstate and international long distance services, the FCC requires us to make the terms, conditions and rates of the detariffed services available to the public on XO's web page, and such terms, conditions, and rates are located at http://www.xo.com/legal/.

Implementation of the Telecom Act

The Telecom Act's Local Competition Framework

One of the key goals of the Telecom Act is to encourage competition in the provision of local telephone service. To do this, the Telecom Act provides three means by which competitive local exchange carriers, or CLECs, such as XO can enter the local telephone service market. The three modes of entry are as follows:

- ***Access to UNEs.*** ILECs are required to lease to CLECs various elements in their network that are used individually or in combination with each other to provide local telephone service. As discussed in more detail below, the FCC determines which facilities must be made available by the ILECs as UNEs. The ILECs must make UNEs available at rates that are based on their forward-looking economic costs, a pricing regime known as "TELRIC," short for Total Element Long Run Incremental Cost. For XO, the most critical UNEs are local loops and transport, which enable us to connect our customers to our network.
- ***Construction of New Facilities.*** CLECs may also enter the local service market by building entirely new facilities. The ILECs are required to allow CLECs to interconnect their facilities with the ILECs' facilities in order to reach all customers.
- ***Resale.*** ILECs are required to permit CLECs to purchase their services for resale to the public at a wholesale rate that is less than the rate charged by the ILECs to their retail customers.

To facilitate competitors' entry into local telephone markets using one or more of these three methods, the Telecom Act imposes on the ILECs the obligation to open their networks and markets to competition. When requested by competitors, ILECs are required to negotiate, in good faith, agreements that set forth terms governing the interconnection of their network, access to UNEs, and resale. We have negotiated interconnection agreements with the ILECs in each of the markets in which we operate. Many of these interconnection agreements are currently being renegotiated.

The following is a summary of the interconnection and other rights granted by the Telecom Act that are important for effective local service competition and our belief as to the effect of those requirements, if properly implemented:

- interconnection with the networks of incumbents and other carriers, which permits our customers to exchange traffic with customers connected to other networks;

- requirements that the ILECs make available access to their facilities for our local loops and transport needs, thereby enabling us to serve customers not directly connected to our networks;
- compensation obligations, which mandate reciprocal payment arrangements for local traffic exchange between us and both incumbent and other competitive carriers and compensation for terminating local traffic originating on other carriers' networks;
- requirements concerning local number portability, which allows customers to change local carriers without changing telephone numbers, thereby removing a significant barrier for a potential customer to switch to our local voice services;
- access to assignment of telephone numbers, which enables us to provide telephone numbers to new customers on the same basis as incumbent carriers; and
- collocation rights allowing us to place telecommunications equipment in ILEC central offices, which enables us to have direct access to local loops and other network elements.

Although the rights established in the Telecom Act are a necessary prerequisite to the introduction of full local competition, they must be properly implemented and enforced to permit competitive telephone companies like XO to compete effectively with the incumbent carriers. Discussed below are several FCC and court proceedings relating to the application of certain FCC rules and policies that are significant to and directly impact our operations and costs as well as the nature and scope of industry competition.

Unbundling of Incumbent Network Elements

In a series of orders and related court challenges that date back to 1996, the FCC has promulgated rules implementing the market-opening provisions of the Telecom Act, including the requirement that the ILECs lease UNEs to competitors at cost-based rates. At the core of the series of FCC orders is the FCC's evolving effort to define which ILEC network facilities must be made available as UNEs. Initially, the FCC defined a broad list of UNEs, consisting of most of the elements of the ILECs' networks. Under pressure from the ILECs, the FCC has subsequently reduced the list, while preserving access to those network elements critical to the operation of XO's business.

The current list of UNEs was promulgated by the FCC in two orders. The first is the Triennial Review Order, or TRO, which was released on August 21, 2003. Several carriers and other entities appealed the FCC's TRO decision. On March 2, 2004, the U.S. Court of Appeals for the D.C. Circuit issued its opinion in United States Telecom Association v. FCC, No. 00-1012 ("USTA II Decision"). In the USTA II Decision, the court reversed and overturned many of the conclusions of the TRO. In the aftermath of the USTA II Decision, the FCC released the second of its two currently controlling orders, the TRRO, on February 4, 2005. Various parties, including XO, have appealed the TRRO. The case is currently pending before the United States Court of Appeals for the D.C. Circuit. It is not possible to predict the outcome of those appeals. It is possible that portions of the TRRO could be overturned and that the FCC will issue new rules in their place that further restrict access to UNEs.

As of March 11, 2005, the effective date of the TRRO, the ILECs are obligated to provide as UNEs the following network facilities used by XO to serve its customers:

UNE Loops

DS0 loops. A DS0 loop is a single, voice-grade channel. Typically, individual business lines are DS0 loops. The ILECs must make DS0 loops available at UNE rates on an unlimited basis.

DS1 loops. A DS1 loop is a digital loop with a total speed of 1.544 megabytes per second, which is the equivalent of 24 DS0 circuits. Multiple voice lines and Internet access can be provided to a customer over a single DS1 loop. We provide most of our service with DS1 loops. The ILECs must provide DS1 loops at UNE rates at the majority of their central offices. Competitors, however, are limited to no more than 10 DS1 loops to any particular building.

DS3 loops. A DS3 loop is a digital loop with a total speed of 44.736 megabytes per second, which is the equivalent of 28 DS1 circuits. In some cases, XO serves its large business customers with DS3 loops. ILECs must provide DS3 loops at UNE rates at the majority of their central offices. Competitors, however, are limited to no more than one DS3 loop to any particular building.

ILECs are not required to provide optical capacity loops or dark fiber loops as UNEs. Optical capacity loops, referred to as OCn loops, are very high-capacity digital loops ranging in capacity from OC3 loops, which are the equivalent of three DS3s to OC192. This will not impact our costs.

The ILECs are also not required to provide certain mass market broadband loop facilities and functionality as UNEs. Under the TRO, the ILECs are not required to make newly-deployed fiber-to-the-home, or FTTH, loops available as UNEs and are only required to provide the equivalent of DS0 capacity on any FTTH loop built over an existing copper loop. These recent FCC orders should only limit availability for those specific network elements, which are not material to us. It is possible, however, that the ILECs will seek additional broadband regulatory relief in future proceedings.

UNE Transport

DS1 transport. Whether transport is available as a UNE is determined on a route-by-route basis. ILECs must make transport at UNE rates available at DS1 capacity levels between any two ILEC central offices unless both central offices either (1) serve more than 38,000 business lines or (2) have four or more fiber-based collocators. On routes where DS1 transport must be made available, each individual competitor is limited to no more than 10 DS1 transport circuits per route.

DS3 transport. Access to DS3 capacity-level transport is more limited than access to DS1 transport. ILECs must make transport at UNE rates available at DS3 capacity levels between any two ILEC central offices unless both central offices either (1) serve more than 24,000 business lines or (2) have three or more fiber-based collocators. On routes where DS3 transport must be made available, each individual competitor is limited to no more than 12 DS1 transport circuits per route.

Dark fiber transport. Dark fiber transport is available under the same conditions as DS3 transport.

ILECs are not required to provide access to transport at greater-than DS3 capacity levels. ILECs are also not required to provide dark fiber transport at any capacity level to connect an ILEC central office with a competitor's facilities.

Transitional availability where elements are no longer available as UNEs

For DS1, DS3, and dark fiber loops and transport that do not meet the criteria for availability set forth above, the FCC established a transitional period during which the ILECs must continue to make the elements available at UNE rates to serve existing customers. For DS1 and DS3 loops and transport, the ILECs must make the elements available at 115% of the TELRIC rate for one year beginning on March 11, 2005. For dark fiber loops and transport, the ILECs must make the elements available at 115% of the TELRIC rate for 18 months beginning on March 11, 2005.

Although these rules adopted by the FCC in the TRRO became effective on March 11, 2005, many of the requirements imposed by the FCC in the TRO and TRRO were not self-executing. Accordingly, the FCC made clear that carriers must follow the change of law procedures in their applicable interconnection agreements with ILECs to implement any TRO requirements that are not self-executing and that carriers must follow the procedures set forth in Section 252(b) of the Telecom Act to modify interconnection agreements that are silent as to implementation of changes in law. We have been in negotiations with ILECs to amend our interconnection agreements to implement relevant TRO requirements and, to date, have executed amendments in several states.

Additional Federal Regulations

The following discussion summarizes some additional specific areas of federal regulation that directly affect our business.

VoIP. Like a growing number of carriers, we utilize IP technology for the transmission of a portion of our network traffic. The regulatory status and treatment of IP-enabled services is unresolved. In a recent order, the FCC held that Vonage's VoIP services and similar offerings by other providers are subject to the FCC's interstate jurisdiction, preempting state efforts to regulate VoIP providers as intrastate telecommunications providers. Four separate state commissions have appealed this ruling and the case is currently pending. The FCC, however, left open the question of whether VoIP providers provide "telecommunications" — i.e., basic transmission services — or enhanced "information services." Under the Communications Act of 1934, as amended, or the Communications Act, those are mutually exclusive categories. Generally, telecommunications carriers, including traditional local and long distance telecommunications companies, are regulated under the Communications Act; information service providers are generally unregulated. The FCC has initiated a rulemaking proceeding to address the classification of VoIP and other IP-enabled service offerings. It is not possible to predict the outcome of that proceeding or its effect on XO's operations. In conjunction with the rulemaking proceeding, the FCC is considering a petition filed on February 5, 2004 by SBC Communications requesting that the FCC forbear from applying common carrier regulation to IP-based networks. Under the Communications Act, the FCC must act on forbearance petitions within one year, or the petition is deemed granted, subject to a single, 90-day extension available to the FCC at its discretion. On May 5, 2005, the FCC denied SBC's petition.

AT&T Declaratory Ruling Re: VoIP. On April 21, 2004, the FCC released an order, the AT&T Order, denying AT&T's request that the FCC find that VoIP services are exempt from switched access charges. The FCC held that an interexchange service that uses ordinary customer premises equipment that originates and terminates on the public switched telephone network, or PSTN, that provides no enhanced functionality, and that undergoes no net protocol conversion, is a telecommunications service and subject to switched access charges. The AT&T order apparently places interexchange services similar to those VoIP services offered by AT&T in the same regulatory category as traditional telecommunications services and, therefore, potentially subjects such VoIP services to access charges and other regulatory obligations including Universal Service fees. Although the FCC did not rule on the applicability of access charges for services provided prior to April 21, 2004, the ILECs may attempt to assert claims against other telecommunications companies including us for the retroactive payment of access charges. On April 22, 2004, SBC Communications filed a collections lawsuit against AT&T and other carriers seeking retroactive payment of unpaid access charges. On February 4, 2005, SBC amended an existing collection case it had filed against Global Crossing and filed a complaint against XO.

Level 3 Forbearance Petition. On December 23, 2003, Level 3 filed a petition requesting the FCC not to apply interstate or intrastate access charges on IP traffic that originates or terminates on the PSTN. Level 3 withdrew that petition on March 21, 2005, shortly before the FCC's statutory deadline for acting. Some observers have interpreted Level 3's withdrawal of the petition as a signal that the FCC was not likely to rule in Level 3's favor. The FCC may ultimately rule on this issue either in its VoIP rulemaking proceeding or in the intercarrier compensation reform proceeding discussed below. The issue of whether access charges apply to VoIP and other IP traffic that originates or terminates on the PSTN is potentially significant for XO and other carriers.

ILEC Provision of Broadband Telecommunications Services and Information Services. Currently, the ILECs, as dominant carriers, are subject to a relatively high degree of regulation with respect to their broadband service offerings. The FCC, however, has initiated a rulemaking proceeding in which it is considering deregulating, or applying a lower degree of regulation to, ILEC broadband offerings. If the ILECs are largely freed from dominant carrier regulation, they will have much greater pricing flexibility and will pose a greater competitive threat to XO. In a second, related rulemaking, the FCC is considering whether to eliminate certain requirements it imposes on the ILECs with respect to their broadband Internet access services. Currently, where the ILECs offer Internet access or other information services over broadband facilities, they must (1) purchase the underlying broadband transmission facilities from themselves at tariffed rates and (2) make the underlying facilities available to competitors on a non-discriminatory basis. If the FCC were to eliminate these requirements, it could result in an increase to our network costs. To date, these deregulatory trends have been directed towards facilities used primarily by residential customers, and not by business customers.

Intercarrier Compensation Reform. Currently, telecommunications carriers are required to pay other carriers for interstate access charges and local reciprocal compensation charges. These two forms of intercarrier compensation have been under review by the FCC since 2001. The FCC continues to consider a broad order reforming the intercarrier compensation system and issued a Notice of Proposed Rulemaking on February 10, 2005 to seek further comment on intercarrier compensation reform. Although we are unable to predict the outcome of the FCC's rulemaking procedures, inasmuch as access charges and reciprocal compensation payments make up our largest network expense item, the FCC's action could have a material, adverse affect on our operations and cost of doing business.

Cost-based TELRIC Pricing. On September 10, 2003, the FCC initiated a new proceeding to consider significantly revamping the current TELRIC methodology used for the pricing of UNEs. If the FCC reverses the methodology used for determining UNE rates to allow for rate increases, this could substantially raise XO's costs for leasing UNEs in the future. A decision is expected sometime in 2005. Several state commissions have also initiated proceedings to review the rates that the ILECs charge for UNEs. An adverse ruling in these proceedings would allow the ILECs to increase UNE rates in the applicable state and this could substantially raise our costs for leasing UNEs in the future.

State and Local Regulation

In general, state regulatory commissions have regulatory jurisdiction over us when our facilities and services are used to provide local and other intrastate services. Under the Telecom Act, state commissions continue to set the requirements for providers of local and intrastate services, including quality of services criteria. State regulatory commissions also can regulate the rates charged by CLECs for intrastate and local services and can set prices for interconnection by new telecommunications service providers with the ILEC networks, in accordance with guidelines established by the FCC. In addition, state regulatory commissions in many instances have authority under state law to adopt additional regulations governing local competition and consumer protection, as long as the state's actions are not inconsistent with federal law or regulation.

Most state regulatory commissions require companies that wish to provide intrastate common carrier services to register or be certified to provide these services. These certifications generally require a showing that the carrier has adequate financial, managerial and technical resources to offer the proposed services in a manner consistent with the public interest. We are certified in all of the states in which we conduct business. In most states, we are also required to file tariffs setting forth the terms, conditions and prices for services that are classified as intrastate, and to update or amend our tariffs as rates change or new products are added. We may also be subject to various reporting and record-keeping requirements.

Where we choose to deploy our own transmission facilities, we may be required, in some cities, to obtain street opening and construction permits, permission to use rights-of-way, zoning variances and other approvals from municipal authorities. We also may be required to obtain a franchise to place facilities in public rights-of-way. In some areas, we may be required to pay license or franchise fees for these approvals. We cannot provide assurances that fees will remain at current levels, or that our competitors will face the same expenses, although the Telecom Act requires that any fees charged by municipalities be reasonable and non-discriminatory among telecommunications carriers.

California Public Utilities Commission Proceeding. On September 23, 2004, the California Public Utilities Commission, or the CA Commission, issued a decision that required SBC to adjust monthly recurring rates for certain types of services offered to CLECs by SBC. As a result of that decision, we believed that we were owed a retroactive credit. The billing adjustments and true-up payments required by the decision had been stayed until the CA Commission could: (a) consider mitigations to lessen the negative effect of such true-up payments; and (b) consider issues raised by the U.S. Court of Appeals for the Ninth Circuit regarding the shared and common cost mark-up element. After issuance of the September 23, 2004 decision, the CA Commission issued three separate alternate draft decisions all of which proposed different true-up payment schemes and different shared and common cost mark-up factors as well as retroactive and non-retroactive treatment of the mark-up factor. These three alternate decisions were contentious and were being debated by the CA Commission and various parties to the proceeding. On March 22, 2005 XO and SBC executed a settlement agreement resolving these issues. As a result of this settlement, on March 25, 2005 SBC made a payment to XO of approximately $10.0 million. The settlement agreement provides XO with finality on these issues as the settlement agreement prohibits SBC from seeking rehearing before the CA Commission or appealing to any state of federal court the true-up or payment of the true-up monies to XO.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We had $374.2 million in secured loans as of March 31, 2005. Currently, we do not pay cash interest on the loans under the Credit Facility.

Marketable securities and other investments at March 31, 2005 consist primarily of investments in equity and debt investments of publicly-traded companies. The fair value of our investment in equity and debt securities exposes us to market risk; however, if the fair value were to increase or decrease immediately, it would not likely have a material impact on our financial position or our results of operations. We are not currently engaged in the use of off-balance sheet derivative financial instruments, to hedge or partially hedge interest rate exposure nor do we maintain any other off-balance sheet arrangements for the purposes of credit enhancement, hedging transactions, or other financial or investment purposes.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. These rules refer to the controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. Our Principal Executive Officer and our Principal Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on the evaluation, they have concluded that, as of the end of such period, the controls and procedures were effective at ensuring that required information was accurate and disclosed on a timely basis in our report filed under the Exchange Act.

Changes in Internal Controls

We maintain a system of internal accounting controls that is designed to provide reasonable assurance that our books and records accurately reflect our transactions and that our established policies and procedures are followed.

During the first quarter of 2005, we implemented a new sales commissioning system and began migrating certain customers to a new billing system, which resulted in changes to our internal controls over financial reporting.

Except as noted above, there were no other changes to our internal controls that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are is involved in lawsuits, claims, investigations and proceedings consisting of commercial, regulatory, securities, tort and employment matters, which arise in the ordinary course of business. In accordance with Statement of Financial Accounting Standards No. 5, " Accounting for Contingencies," we make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. We believe we have adequate provisions for any such matters. We review these provisions at least quarterly and adjust these provisions to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to legal matters pending against the Company. Nevertheless, it is possible that cash flows or results of operations could be materially and adversely affected in any particular period by the unfavorable resolution of one or more of these contingencies.

We filed an administrative claim in August 2004 against the Allegiance Telecom Liquidating Trust (the "ATLT"). We have claimed that we are entitled to approximately $50 million in damages related to a variety of actions allegedly taken by Allegiance and the ATLT. The ATLT filed a counterclaim against us on November 24, 2004 seeking damages of approximately $100.0 million, which claim we believe to be frivolous and without merit. The case went to trial in the United States Bankruptcy Court for the Southern District of New York on May 2, 2005.

In addition, disputes with respect to general unsecured claims and one administrative claim against us in the amount of approximately $2.1 million remain pending from the our 2002 Chapter 11 proceedings.

Item 2. Changes in Securities and Use of Proceeds

None.

Item 3. Defaults Upon Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the three months ended March 31, 2005.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

10.1 Agreement, dated as of May 9, 2005, by and between XO Communications, Inc., Arnos Corp., High River Limited Partnership, and Cardiff Holding LLC.

31.1 Rule 13a — 14(a)/15(d) — 14(a) Certification

31.2 Rule 13a — 14(a)/15(d) — 14(a) Certification

32.1 Certificate pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certificate pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrants have duly caused this report to be signed on their behalf by the undersigned thereunto duly authorized.

XO Communications, Inc.

Date: May 9, 2005

By: /s/ William Garrahan
William Garrahan
Senior Vice President and
Acting Chief Financial Officer
(Principal Financial Officer)

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Exhibit 10.1

AGREEMENT

This Agreement is by and among XO Communications, Inc., a Delaware corporation ("XO" or the "Company"), certain Subsidiaries of the Company, as Guarantors, as defined under the terms of that certain Amended and Restated Credit and Guaranty Agreement, dated as of January 16, 2003 (the "Credit Agreement"), by and among the Company, certain Subsidiaries of the Company, as Guarantors, the lenders identified on the signature pages thereto (the "Lenders"), and Mizuho Corporate Bank, Ltd., as Administrative Agent (together with its permitted successors in such capacity, the "Agent"), the Requisite Lenders, as defined under the terms of the Credit Agreement, and Cardiff Holding, LLC (the "Investor"), and holder of 3,800,000 shares of the Company's 6% Class A Convertible Preferred Stock, $0.01 par value per share (the "Preferred Stock").

RECITALS

A. Pursuant to Section 10.5 of the Credit Agreement, the Requisite Lenders have the right to waive provisions of the Credit Documents or consent to a departure of any Credit Party and such waiver shall be effective upon written concurrence of the Requisite Lenders (capitalized terms used herein without definition being used as defined in the Credit Agreement).

B. The undersigned Lenders constitute the Requisite Lenders pursuant to Section 1.1 of the Credit Agreement.

C. The Company anticipates that it will not be in compliance with Section 6.6(b) of the Credit Agreement for the fiscal quarters ended March 31, 2006, June 30, 2006, September 30, 2006 and December 31, 2006.

D. The undersigned Lenders are prepared to waive compliance by the Company with the requirements of Section 6.6(b) of the Credit Agreement on the terms and for the periods set forth below and for and in consideration of the covenants and agreements of the Company contained herein.

E. The powers, preferences, and relative, participating, optional, and other special rights of the Preferred Stock are set forth in that certain Certificate of Designations adopted and approved by the Company's Board of Directors on August 5, 2004 (the "Certificate").

NOW, THEREFORE, in consideration of the premises, and the mutual covenants and agreements herein contained, the parties hereto hereby agree as follows:

AGREEMENT

1. Waiver. Effective as of the date of this Waiver, the Requisite Lenders hereby waive compliance by the Company and the Guarantors with the requirements of Section 6.6(b) of the Credit Agreement for each of the four fiscal quarters ended March 31, 2006, June 30, 2006, September 30, 2006 and December 31, 2006.

2. Acknowledgement. Except as expressly provided in Section 1, (a) the execution, delivery, and performance of this Agreement shall not constitute a waiver of any provision of, or operate as a waiver of any right, power, or remedy of the Agent or any Lender under the Credit Agreement or any other Credit Document, and (b) the Credit Agreement and the other Credit Documents shall remain in full force and effect and are hereby ratified and confirmed. The provisions of Section 3 below provide rights in addition to and not in limitation of, those set forth in the Credit Agreement and in the other Credit Documents.

3. Prepayment and Repurchase Upon Consummation of a Company Sale.

(a) Upon the consummation of any Qualifying Company Sale (as defined below), the Company will (i) prepay the Term Loans and all other Obligations outstanding thereunder and under the Credit Agreement and other Credit Documents in full, such payment to be made in U.S. dollars as is required by the Credit Agreement and (ii) consummate an offer (the "Redemption Offer") to all of the holders of Preferred Stock to redeem all of their outstanding shares of Preferred Stock at the Liquidation Preference thereof, (calculated through the date of such redemption) (the "Redemption Amount") upon the terms and subject to the conditions set forth below. A "Qualifying Company Sale" is (i) any Company Sale pursuant to a definitive agreement entered into on or before December 31, 2006 and (ii) any other Company Sale, regardless of the date the applicable definitive agreement was entered into, if such Company Sale was deemed, pursuant to the definitive agreement relating to the previous Qualifying Company Sale, to be a superior proposal to such prior Qualifying Company Sale.

(b) In the Redemption Offer, the Company shall offer to redeem the Preferred Stock for cash, *provided* that if and to the extent the acceptance of the Redemption Offer (after giving effect to the repayment of all Term Loans and other Obligations outstanding under the Credit Agreement as contemplated by Section 3(a)) would leave the Company and its Subsidiaries with total cash and marketable securities of less than $80 million, then, the Company may offer as consideration for all or the remainder of the Redemption Amount (as the case may be) any other consideration it has received in the Company Sale in the form of securities or debt or other financial obligations of any kind (the "Other Consideration"), valued as follows: (i) if the Other Consideration is assigned a dollar value in the Company Sale, it will be so valued for purposes of the Redemption Offer; (ii) if no such value is assigned, the Other Consideration will be valued at the average of the daily closing price therefor on the principal exchange or securities market on which it is traded for the 10 trading days immediately preceding the Closing of the Company Sale; and (iii) if no such market price is available for such Other Consideration, at its fair market value (being the price that a willing buyer under no compulsion to buy would pay to a willing seller under no compulsion to sell); *provided* that if the holder of a majority of the shares of Preferred Stock outstanding at the time and a special committee of the Board of Directors of the Company consisting solely of independent directors agree on an amount as the fair market value then such amount shall be deemed to be the fair market value for this purpose.

In the event that different types of Other Consideration are offered in the Redemption Offer, the most liquid kind of Other Consideration shall be offered first, followed by the next most liquid kind, etc.

The Company will use all commercially reasonable efforts to (x) obtain all customary and appropriate registration rights and other rights with respect to any Other Consideration, in each case designed to ensure that it will be marketable within a reasonable period of time and (y) ensure that such rights are assignable in the Redemption Offer. Any Other Consideration offered in a Redemption Offer will be offered together with any such rights. Cash and all types of Other Consideration shall be allocated pro rata among the accepting offerees in the respective amounts in which each is being offered as consideration in the Redemption Offer.

(c) The Redemption Offer shall be conditioned upon the closing of the applicable Company Sale, and payment shall be made pursuant thereto to all properly accepting holders of Preferred Stock on the date of such closing. The Redemption Offer shall be made in writing at least 20 Business Days prior to the earliest reasonably anticipated date for the consummation of the Company Sale and shall be mailed to all holders of Preferred Stock of record on the most recent practicable date prior to such mailing. The Redemption Offer shall be made in compliance with all applicable laws and in accordance with such procedures as the Board of Directors of the Company shall reasonable determine, and shall remain open, subject to the right of accepting shareholders to withdraw their acceptances at any time prior to the consummation of the Redemption Offer, until a date (the "Redemption Date") on which the Company Sale is consummated or such later date as represents the minimum time required by applicable law. The Redemption Offer will require accepting holders of Preferred Stock to surrender the certificate or certificates representing their tendered shares to the Company, duly endorsed (or otherwise in proper form for transfer, as determined by the Company), in the manner and at the place designated in the Redemption Offer, and each surrendered certificate shall be canceled and retired and thereafter represent only the right to receive the Liquidation Preference attributable to the shares so redeemed calculated as of the Redemption Date.

(d) The Investor agrees, on behalf of itself and any of its Affiliates who from time to time may become holders of Preferred Stock, that it will accept the Redemption Offer to the extent that cash is offered as consideration therefor, *provided* that the Investor and such Affiliates shall not be required to accept the Redemption Offer if, but only to the extent, that such acceptance would reduce the ownership of the Investor and its Affiliates of Preferred Stock to less than an absolute majority of the shares of

Preferred Stock outstanding immediately following consummation of the Redemption Offer. For the avoidance of doubt, the Investor shall in no event be required to accept any portion of the Redemption Offer consisting of Other Consideration.

(e) A "Company Sale" means any of the following: (i) any Change of Control of the Company, (ii) a sale of all or substantially all of the assets or business of the Company and/or its Subsidiaries, directly or indirectly, whether through the sale of stock of, or other equity interests in, Subsidiaries, sale of assets, merger, consolidation, other business combination, or any combination thereof, (ii) a sale of assets of the Company and/or its Subsidiaries (directly or indirectly, whether through the sale of stock of, or other equity interests in, Subsidiaries, sale of assets, merger, consolidation, other business combination or any combination thereof) representing 50% of more of (x) the total book value of the consolidated total assets of the Company and its Subsidiaries, exclusive of cash and marketable securities as of the last month-end prior to the execution of the contract providing for the actions described in this subsection (ii) (the "Contract"), or (y) to which 50% or more of the consolidated total revenues of the Company and its Subsidiaries from operations during the 12-month period ending on the last month-end prior to the execution of the Contract are attributable, (iii) any merger, liquidation, business combination or consolidation transaction in which shares of the Company's common stock are converted into the right to receive cash and/or securities of an acquiring Person or any other entity or issuer or (iv) any other transaction or series of related transactions having an economic effect substantially equivalent to any of the foregoing.

4. Governing Law. This Agreement and the rights and obligations of the parties hereunder shall be governed by, and shall be construed and enforced in accordance with, the internal laws of the State of New York, without regard to conflicts of laws principles.

5. Counterparts. This Agreement may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which when so executed and delivered shall be deemed an original, but all such counterparts together shall constitute but one and the same instrument; signature pages may be detached from multiple separate counterparts and attached to a single counterpart so that all signature pages are physically attached to the same document.

[Remainder of Page Intentionally Left Blank]

IN WITNESS WHEREOF, the Lenders and the Investor have caused this Agreement to be duly executed and delivered by their respective officers thereunto duly authorized as of the date first written above.

LENDERS:

ARNOS CORP.

By: /s/ Edward E. Mattner
Name: Edward E. Mattner
Title: Vice President

HIGH RIVER LIMITED PARTNERSHIP

By: Hopper Investments, LLC, a General Partner

By: Barberry Corp, Member

By: /s/ Edward E. Mattner
Name: Edward E. Mattner
Title: Authorized Signatory

INVESTOR:

CARDIFF HOLDING, LLC

By: Tramore LLC, Managing Member

By: /s/ Edward E. Mattner
Name: Edward E. Mattner
Title: Authorized Signatory

Agreed and Acknowledged:

XO COMMUNICATIONS, INC.

/s/ William Garrahan
William Garrahan
Senior Vice President and Acting Chief Financial Officer

GUARANTORS:

ALLEGIANCE TELECOM OF FLORIDA, INC.
ALLEGIANCE TELECOM OF ILLINOIS, INC.
ALLEGIANCE TELECOM OF COLORADO, INC.
ALLEGIANCE TELECOM OF TEXAS, INC.
LHP EQUIPMENT, INC.
TELECOMMUNICATIONS OF NEVADA, LLC
V&K HOLDINGS, INC.
XO ASIA LIMITED
XO COLORADO, LLC
XO COMMUNICATIONS SERVICES, INC.
XO DATA SERVICES, LLC
XO DOMESTIC HOLDINGS, INC.
XO FLORIDA, INC.
XO GLOBAL COMMUNICATIONS, INC.
XO ILLINOIS, INC.
XO INTERACTIVE, INC.
XO INTERCITY HOLDINGS NO.1, LLC
XO INTERCITY HOLDINGS NO.2, LLC
XO INTERNATIONAL HOLDINGS, INC.
XO INTERNATIONAL, INC.
XO LONG DISTANCE SERVICES, INC.
XO LONG DISTANCE SERVICES (VIRGINIA), LLC
XO LMDS HOLDINGS NO. 1, INC.
XO NETWORK SERVICES (VIRGINIA) LLC
XO MANAGEMENT HOLDINGS, INC.
XO MANAGEMENT SERVICES, INC.
XO MANAGEMENT SERVICES, NEVADA, INC.
XO MINDSHARE, LLC
XO MINNESOTA, LLC
XO NEVADA MERGER SUB, INC.
XO ONE, INC.
XO SERVICES, INC.
XO TEXAS, INC.
XO VIRGINIA, LLC

/s/ William Garrahan
William Garrahan
Senior Vice President and Acting Chief Financial Officer

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